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C O N F I D E N T I A L SECTION 01 OF 04 RANGOON 000892

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E.O. 12958: DECL: 09/19/2018
TAGS: EFIN ECON PGOV IMF BM
SUBJECT: BURMA: IMF CONDUCTS ARTICLE IV CONSULTATIONS

REF: A. RANGOON 836
¶B. RANGOON 604
¶C. RANGOON 596
¶D. RANGOON 663

RANGOON 00000892 001.2 OF 004

Classified By: Economic Officer Samantha A. Carl-Yoder for Reasons 1.4 (b and d).

Summary

¶1. (C) An International Monetary Fund (IMF) team visited Burma October 22-November 6 for annual Article IV consultations. While the IMF estimates Burma's real GDP growth in 2008 will be 4 percent, rather than the 13 percent touted by the GOB, the team remains unable to reconcile national accounts to determine a realistic GDP figure. Visiting IMF officials also expressed concern about Burma's large fiscal deficits caused by high infrastructure expenditures (including construction in Nay Pyi Taw), multiple exchange rates (which the GOB refuses to unify), and persistent high inflation. The IMF cited declining capacity among government economic officials and has offered technical assistance to upgrade skills. Its detailed findings will be made available to the Board, although visiting officials declined to share them with us due to confidentiality concerns. Embassy Rangoon requests a copy of the report after it is sent to the Board. End Summary.

¶2. (C) The IMF team was led by Ranil Salgado and included representatives of the World Bank and the Asian Development Bank. The team met the Central Bank Governor, Minister of Agriculture, Minister of National Planning, and officials from the Ministries of Finance, Statistics, Social Welfare,

and Health. Additionally, they met with businessmen and private bankers, the Chamber of Commerce, and representatives of select Embassies and UN agencies. (Note: Last year's IMF team met with additional GOB ministries and agencies. End Note.) The team noticed clear capacity issues: experienced, erudite civil servants are reaching retirement and their replacements have lower-quality educations and little to no exposure to the outside world. The IMF's key Ministry of Finance contact, a qualified economist who openly and frankly discussed economic issues with the IMF, retired in early 2008; the IMF has yet to find a GOB official to fill that role.

IMF Recommendations

¶3. (C) At an inbrief with Post at the beginning of its Article IV Consultations, the IMF team told us it would limit recommendations to the GOB to one or two key reforms, rather than a slate of changes as proposed in the past (Ref A). However, the IMF decided against this initial plan. Salgado told diplomats at a November 5 briefing that the GOB faces clear and fundamental economic problems, and he argued that to recommend only a few changes would be irresponsible. Similar to last year, the IMF made the following recommendations to the GOB:

--Unify exchange rates, eliminating the gap between the official and black market rates for kyat;
--Create and maintain an independent Central Bank;
--Reduce the budget deficit in order to combat inflation;
--Create capital markets (including a bond market) to further reduce inflation;

--Update its CPI index to accurately measure inflation;
--Continue to liberalize the agricultural sector;
--Balance the budget; and
--Further strengthen its anti-money laundering legislation.

Salgado told us he expected that the team's recommendations would be relayed to the Cabinet, but he doubted Senior General Than Shwe and other top leaders would review the final report.

Lower GDP Growth and Higher Budget Deficits

¶4. (C) The IMF team told diplomats and UN officials during its outbrief that Burma's economy is not performing at the level it should, given the country's abundant resources and economic potential. The IMF rejected GOB GDP growth estimates (13 percent in 2008) as unrealistic. Instead, the team estimates that the real 2008 growth rate will hover around 4 percent, due to increased production in the agricultural and oil and gas sectors. Embassy officials noted at the briefing that given the decreasing price of natural gas on the world market, GDP growth could be even lower. The IMF team agreed and noted that despite working with GOB experts, the team remains unable to reconcile national accounts to determine a realistic GDP figure.

¶5. (C) The GOB informed the IMF team that revenues from tax collection increased in FY07, resulting in a lower budget deficit. We pointed out that the figures the GOB provided to the IMF team were different from those in the published FY08 budget. The GOB's actual budget deficit in FY07 was 1.7 trillion kyat (USD 1.4 billion), substantially higher than the FY06 budget deficit of 235.8 billion kyat (USD 196 million). The GOB predicts a budget deficit of 415 billion kyat for FY08-09 (USD 377 million), which does not include a budget supplemental (Ref B). The IMF requested that we provide them with our analysis of the FY08 GOB budget; we did so before they departed Rangoon.

Resource Allocation and High Inflation Key Concerns

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¶6. (C) The real problem, Salgado noted at the briefing, is not the growth rate, but rather how resources are allocated. The GOB fails to see the benefits of growth, as money is controlled by the military and not spent on education, health, and social welfare programs that would benefit the poor and raise the collective standard of living. Despite more than USD two billion in annual oil and gas revenues, a majority of Burmese remain poor (Ref B). (Note: Salgado acknowledged that the GOB maintains two budgets -- a kyat budget, which it publishes annually, and a U.S. dollar budget. The IMF during its trip was only able to reconcile the kyat budget, and could not state whether the GOB used any revenues in the USD budget for national programs. End Note.) The IMF again strongly recommended the GOB increase expenditures on health and education.

¶7. (C) Although he could not discuss the statistics in detail for confidentiality reasons, Salgado estimated that the money supply remains stable at between 2.5 and 3 trillion kyat. IMF Economist Tubagus Feridhanusetyawan told diplomats that there was a substantial increase in the FEC supply after Cyclone Nargis, as the GOB replaced U.S. dollar-denominated aid contributions with FEC. The IMF team, using GOB figures, estimated that year-on-year inflation was around 30 percent.

Inflation continues to be fueled by a loose monetary policy -- printing money -- which finances the deficit. The government has yet to update its consumer price index, which is based on 1987 prices and uses an old data basket; its inflation figures thus do not reflect the current situation.

¶8. (C) Salgado commented that the market rate for the kyat does not appear to be depreciating dramatically, signifying that inflation is not spiraling out of control. The IMF reiterated its advice that the government unify the exchange rate (which varies from the official rate of 6 kyat/1 USD to 1275 kyat/1 USD on the black market). Once again, GOB officials expressed great reluctance to make any adjustments, and pointed to the growing inflation rate as justification for inaction.

¶9. (C) We pointed out at the briefing that GOB financial figures are not reliable and do not accurately measure inflation. (Note: Embassy and UN calculations estimate inflation at 50 percent nationwide). We also highlighted that lower prices are not necessarily an indication of reduced inflation, but are related at least in part to GOB price controls. The Singapore DCM emphasized that the nationwide perception is that inflation is increasing, rather than decreasing as the GOB claims. UNDP officials stated that Burmese spend approximately 70 percent of their salaries on food; sustained high levels of inflation will only erode their purchasing power, bringing more people under the poverty line.

Economic Impact of Nargis

¶10. (C) According to Salgado, the IMF team had expected Cyclone Nargis would have significantly affected Burma's economic development. After the two-week visit, the IMF team was more optimistic about the country's recovery, noting that agricultural production in the Delta is expected to be significantly higher than reported in July in the Post Nargis Assessment Report (PONJA) report. The IMF team also heard from Tripartite Core Group (TCG) members that many Burmese were returning to their livelihoods, speeding up economic recovery. Government officials told the IMF team that the GOB had pledged 80 billion kyat (USD 67 million) for cyclone relief and recovery, although only obligated 30 million kyat (USD 25,000) to date for agriculture, infrastructure, and social welfare recovery. The IMF team encouraged the GOB to quickly fulfill its pledge to assist cyclone victims.

¶11. (C) The IMF team reviewed the facts around the FEC depreciation (Ref C), and praised the GOB for taking steps to resolve the reasons for the depreciation (Ref D). UN Resident Coordinator Bishow Parajuli interjected that the TCG played an important role in managing the FEC situation, as the Ministry of Planning initially refused to discuss the FEC depreciation. The IMF argued that in addition to allowing UN agencies and NGOs to pay vendors through direct dollar transfers, the GOB also took further measures to make the FEC more attractive vis-a-vis the U.S. dollar and kyat -- for example, the GOB now allows Burmese to buy petrol and diesel at competitive FEC rates, thereby increasing the demand for FEC.

IMF Sees Some Improvements

¶12. (C) The news is not all bad, the IMF explained, citing

positive developments in both the policy and technical arenas. Salgado emphasized improvements in the trade sector, including the streamlining of the process for import and export licenses, which has improved the balance of payments. We pointed out that the GOB has only streamlined import and export permits for foods coming into Burma via the Rangoon International Airport -- less than 5 percent of total imports and exports; it still takes between two weeks to one month for the GOB to grant import/export permits. Additionally, we noted that trade in Burma is dependent upon more than just permits -- Burmese Customs determines how long it takes for a shipment to enter the country. Even if a company can obtain a permit within two weeks, it still faces delays on the customs side. UN officials agreed and warned the IMF team about taking GOB information at face value.

¶13. (C) Feridhanusetyawan reported that the GOB successfully liberalized the agricultural market during the past year by lifting export restrictions on all but one product: rice. (Note: The GOB lifted the ban on rice exports shortly after the IMF team departed Burma.) The IMF team urged the GOB to continue liberalizing the trade sector, including reducing tariffs on non-agricultural products.

¶14. (C) On the technical side, the IMF officials stated that the GOB continues to work with the IMF to strengthen anti-money laundering efforts, including improving banking supervision. The team also praised the GOB's recent actions to make more of its financial data available to the public on the Central Statistics Agency's website. We informed the IMF team that these statistics are not available to those who try to view the website from within Burma.

Comment

¶15. (C) The IMF Article IV team seized on some of the major GOB policy failures and their effects -- poorly allocated resources, high inflation and fiscal deficits, relatively low growth for such a resource-rich country, and endemic poverty. However, the IMF officials -- all but one new to Burma -- demonstrated a poor grasp of the details and seemed to underestimate the economic and financial challenges facing Burma. More troubling, the IMF team displayed a willingness to accept the GOB's explanations and economic statistics at face value, and appeared genuinely surprised when diplomats and UN officials challenged their assumptions. The IMF team took copious notes at the outbrief with diplomats and UN officials, and we hope the collective interventions of Rangoon-based staff will factor into the IMF's evaluation. There are no grounds for a positive assessment of Burma's economy, which continues to deteriorate due to the regime's mismanagement. The IMF's final report should reflect that fact.